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OCTOBER TERM, 1991

NORTHERN NATURAL GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

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REPLY BRIEF OF NORTHERN NATURAL GAS COMPANY

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REPLY BRIEF OF NORTHERN NATURAL GAS COMPANY

Northern Natural Gas Company (Northern) respectfully submits its Reply to the Briefs in Opposition of the Federal Energy Regulatory Commission (FERC) and Producer Respondents (Producers). Neither FERC nor Producers have denied the far-reaching, industry-wide impact of FERC's assertion that it has jurisdiction to regulate gathering under its newly-discovered interpretation of the Natural Gas Act of 1938 (NGA), 15 U.S.C. §717 *et seq.* In their attempts to defend the attenuated theory that jurisdiction over gathering somehow flows from the rate provisions of NGA Sections 4 and 5, 15 U.S.C. §§717c and 717d, FERC and Producers cannot obscure the fact that the opinion below is in direct conflict with express statutory language, opinions of this Court, and opinions of the Tenth Circuit and D.C. Circuit.

ARGUMENT

1. FERC attempts to blur the distinction between gathering and transportation by alleging that gathering conducted by an interstate pipeline prior to interstate transportation "is in reality a single act of interstate transportation" and that gathering "constitutes but one component of a single transaction." (FERC Br. at 14, n. 9; 23.) As noted in Producers' Brief, the opinion below even went so far as to describe the movement of gas through gathering facilities as "transportation" rather than "gathering," stating that " 'the agency may regulate rates charged for *transportation* on the pipeline's own gathering facilities. . . .' " (Producers Br. at 4, citing App. at 3a; emphasis added.) In contrast to these attempts to engulf the activity of "gathering" totally within the activity of "transportation," Congress clearly distinguished between, and separately addressed, "transportation of natural gas in interstate commerce" and "gathering of natural gas," with FERC jurisdiction placed over the former but explicitly

excluded from the latter. NGA Section 1(b), 15 U.S.C. §717(b). FERC's newly-found interpretation of the NGA is directly contradicted by its own past finding that "[t]he history of Commission and court interpretation of Section 1(b) . . . makes clear that there is a distinction between gathering and transportation, such that the two functions are mutually exclusive." *The Superior Oil Co.*, 13 FERC ¶61,218 at 61,497 (1980).[1] FERC cannot be allowed to submerge nonjurisdictional gathering under the rubric of jurisdictional "transportation" and thereby circumvent the clear command of Congress.

FERC next attempts to justify an expansion of its jurisdiction to gathering by arguing that gathering is "integrally tied to" transportation in interstate commerce and "part of a continuous flow of gas over [an interstate pipeline's] own facilities . . . ." (FERC Br. at 11-12.) The flaw in FERC's argument is that Congress was well aware that gathering, interstate transportation and distribution were "integrally tied" when it explicitly excluded gathering and distribution from regulation under the NGA. As stated by this Court, "Congress knew this necessary relationship between production and distribution but excluded the Commission from exercising any direct control or regulation over the actual production and gathering of natural gas." *F.P.C.* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 507 (1949). The fact that gathering is "part of a continuous flow of gas" through gathering, transmission and distribution facilities also was well known to Congress when it placed the gathering and distribution aspects of the natural gas industry beyond FERC's control. As stated by this Court, "Congress was 'meticulous' only to invest the Com-

[1] FERC claims that the legislative history of the NGA should be ignored because "the statement by FPC Solicitor DeVane . . . that the Commission would not have jurisdiction over 'gathering rates' was not addressed to the situation that the Commission confronted here of an integrated pipeline-gatherer establishing putatively separate rates for what is in reality a single act of interstate transportation." (FERC Br. at 14, n. 9.) In light of FERC's own recognition that gathering and transportation are "two functions [that] are mutually exclusive," *Superior Oil*, *supra*, 13 FERC at 61,497, there is no merit to this claim.

mission with authority over certain aspects of this field, leaving the residue for state regulation." *F.P.C.* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 8 (1961) (*Transco*); *Northwest Central Pipeline Corp.* v. *State Corp. Comm'n of Kansas*, 109 S.Ct. 1262, 1273-74 (1989); *Panhandle*, *supra*, 337 U.S. at 502-03.

2. FERC argues that it must extend its jurisdiction to gathering because "state regulation of the gathering service is impracticable." (FERC Br. at 20.) FERC's opinion as to the impracticability of state regulation of gathering, however, does not constitute statutory authority to regulate an area from which it has been expressly excluded by Congress. FERC's argument that state regulation of gathering is impracticable was rejected by the Tenth Circuit, which found that the "assertion that Colorado and Utah have no interest or an adverse interest in this regulation is speculative." *Northwest Pipeline Corp.* v. *F.E.R.C.*, 905 F.2d 1403, 1412 (10th Cir. 1990). FERC's dim view of the ability of states to regulate gathering stands in marked contrast with the fact that states routinely regulate production through proration regulations affecting literally thousands of wells. *See Northwest Central*, *supra*.

FERC claims that the "impracticality of state regulation is illustrated by" an instance in which Northern provides "gathering from two wells in Oklahoma to delivery points in Texas." (FERC Br. at 20, n. 14.) FERC's argument is contradicted by its own prior finding that "gathering does not become jurisdictional on the basis that the facilities employed therefor cross a state line":

> As to the jurisdictional consequences of the subject facilities crossing a state line, we do not believe the Section 1(b) exemption is affected. The exemption in Section 1(b) of gathering from the Commission's Natural Gas Act jurisdiction is made without regard to whether the facilities involved cross a state to state or federal to state boundary. The history of Commission and court interpretation of Section 1(b), as noted *supra*, makes clear

> that there is a distinction between gathering and transportation, such that the two functions are mutually exclusive. Consequently, otherwise non-jurisdictional production or gathering does not become jurisdictional on the basis that the facilities employed therefor cross a state line.

Superior Oil, supra, 13 FERC at 61,497; *Beacon Gasoline Co.*, 30 FERC ¶61,041 (1985); *Chase Gathering Systems, Inc.*, 16 FERC ¶61,199 (1981).

FERC also cannot justify its intrusion into an area Congress has reserved to the states merely by alleging that "no state regulatory body has asserted jurisdiction over the gathering rates at issue here" and that Northern has not contended that "FERC regulation is inconsistent with state law." (FERC Br. at 20.) As an initial matter, Congress did not *require* states to regulate gathering; in excluding gathering from FERC jurisdiction, Congress simply *reserved* such area to the states. *Transco, supra*, 365 U.S. at 8; *Northwest Central, supra*, 109 S.Ct. at 1273-74; *Panhandle, supra*, 337 U.S. at 502-03. Second, FERC's argument as to the absence of conflict with state law overlooks the fact that FERC must first have statutory authority to regulate an area; the *absence* of state regulation does not constitute the *presence* of statutory authority for FERC to regulate. In fact, this absence of state regulation, after over 50 years of gathering service by interstate pipelines, intrastate pipelines, independent gathering companies and natural gas producers, is evidence of the competition which exists in the gathering field, not justification for FERC's intrusion into an area from which it has been explicitly excluded.[2]

3. Quoting the opinion below, FERC alleges that its regulation of gathering rates " 'is the substantial equivalent

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[2] FERC's suggestion that a state may act in the future to regulate gathering rates and that such regulation may interfere with FERC's regulation of sales for resale and transportation in interstate commerce (FERC Br. at 20) is sheer speculation and cannot serve as a prop to support FERC's assertion of jurisdiction over gathering here.

of the control of *rates* for gathering upheld in *Colorado Interstate.*' " (FERC Br. at 16, citing App. at 17a-18a; emphasis added.) Producers go so far as to allege that "[t]his Court has previously held that the *rates* charged for the gathering portion of the transportation service included in the rate for sales for resale can be regulated by the Commission." (Producers Br. at 3; emphasis added.) Both statements confuse FERC's authority to establish a *rate* for the provision of a jurisdictional service and its authority to review the *costs* included in a rate which it establishes for a jurisdictional service. Neither *Colorado Interstate Gas Co.* v. *F.P.C.*, 324 U.S. 581 (1945), nor any other case has ever found that FERC has the authority to do what it has done in this case—establish a *rate* for an interstate pipeline's gathering of gas for third parties. *Colorado Interstate* in fact made clear that while FERC could review the *costs* included in the sales for resale *rate* which it has the authority to establish, it has no authority to establish a *rate* for a nonjurisdictional service because "the authority of the Commission to suspend rates is restricted to rates over which it has jurisdiction." 324 U.S. at 596. Contrary to FERC's claim (FERC Br. at 17, n. 11), such statement is not quoted "out of context," but, like other statements of this Court, makes explicit that FERC's jurisdiction over rates for a service is determined by the jurisdictional provisions of Section 1(b), not the rate provisions of Section 4.[3]

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[3] FERC cites *Mid-America Pipeline Co.* v. *F.P.C.*, 330 F.2d 226, 228-29 (D.C. Cir. 1964), to support its claim that "a finding that FERC has rate jurisdiction over an activity does not require that the Commission have certificate jurisdiction." (FERC Br. at 19, n. 13.) However, *Mid-America* does not support FERC's claim in any respect. In *Mid-America*, the court upheld FERC's refusal to require a certificate for operation of an extraction plant used to extract natural gas liquids from the gas stream and return the residue natural gas to an interstate pipeline. Consistent with *Colorado Interstate*, the court found that the interstate pipeline's jurisdictional customers were protected by FERC's ability to allocate costs in the interstate pipeline's rate case between its jurisdictional service and the nonjurisdictional liquids operation. 330 F.2d at 228-30. Thus, FERC neither required a certificate for operation of the

Producers allege that "[r]ates for gathering charged by interstate pipelines, such as Northern, have routinely been regulated for nearly half a century . . . ." (Producers Br. at 4.) Producers again attempt to confuse FERC's review of gathering costs included in a jurisdictional sale for resale rate with the total absence in over 50 years of NGA regulation of any FERC assertion of jurisdiction to establish rates for the gathering of natural gas by interstate pipelines for third parties. FERC, however, admits that it did not regulate the rates for third party gathering by interstate pipelines because of its view that the volumes were relatively small and " '[t]here was therefore no need to give special scrutiny to gathering rates or services apart from regulation of the sale rates.' " (FERC Br. at 20.) However, the mere fact that there has been an increase in the volumes gathered for third parties does not modify or negate the statutory exclusion of gathering from FERC jurisdiction.[4]

4. FERC attempts to avoid the conflict between the opinion below and *American Gas Association* v. *F.E.R.C.*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 111 S.Ct. 957 (1991) (*AGA*), by claiming that the "attenuated theory of jurisdiction" rejected in *AGA* was not adopted in this case. (FERC Br. at 22-23.) However, the "attenuated theory" of using the rate provisions of NGA Sections 4 and 5 to reach out and control a nonjurisdictional activity that "af-

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extraction plant nor asserted jurisdiction over the rate for sales of natural gas liquids. FERC's role was limited to the allocation of costs between the jurisdictional and nonjurisdictional services.

[4] Producers also confuse FERC's assertion of authority to require the filing of, and FERC determination of, the rate for the nonjurisdictional service of gathering contained in the orders at issue, with the reference to identification of "cost components" in a rate for jurisdictional sales or transportation service contained in FERC's Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,408 (Oct. 18, 1985), FERC Stats. & Regs., Regulations Preambles 1982-1985 ¶30,665 (1985). (Producers Br. at 9-10.) Producers' claim that appeal of the orders at issue is a "collateral attack" on the appeal of the Order No. 436 regulations is so lacking in merit that it was not even discussed by the court below.

fects" a jurisdictional activity is the same in both cases.[5] In direct conflict with the opinion below, *AGA* upheld FERC's own rejection of the "attenuated theory" that jurisdiction flows from the rate provisions of NGA Section 5. (*See* Pet. at 19-23.) As FERC itself stated in one of its orders affirmed in *AGA*:

> Here, pipelines and LDCs would have the Commission go beyond considering the pipeline-producer contracts in establishing the pipeline's jurisdictional rates, such as the pipeline's sale for resale rates. They would have the Commission exercise its section 5 authority with respect to contracts 'affecting' jurisdictional rates to directly modify the contract for the non-jurisdictional first sale from the producer to the pipeline. However, this contract is analogous to the contracts for the non-jurisdictional direct sales involved in *Panhandle* [*Pipe Line Co.* v. *F.P.C.*, 324 U.S. 635 (1945)]. Just as in *Panhandle*, section 5 did not give the Commission authority to modify directly the contract for the non-jurisdictional direct sale, so also section 5 does not give the Commission authority to modify the contract for the non-jurisdictional new gas sales here involved.

Order No. 500-H, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 54 Fed. Reg. 52,344 (Dec. 21, 1989), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶30,867 at 31,540 (1989). FERC itself recognized that if such "attenuated theory" were adopted it "would mean that the Commission could directly modify any non-jurisdictional contract which affected a pipeline's jurisdictional rates, including labor contracts between the pipeline and its employees, contracts for the purchase of office equip-

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[5] In asserting jurisdiction over gathering in its orders at issue in this proceeding, FERC emphasized both the "in connection with" and the "affecting" language of NGA Sections 4 and 5. (App. at 42a-43a; 52a-53a.)

ment, and leases of office space" and "[t]he Commission has never claimed, nor has any court suggested, that section 5 gives the Commission authority to directly modify such contracts." *Id.*

5. FERC fails to explain away its discriminatory assertion of jurisdiction over the gathering conducted by interstate pipelines, but not gathering conducted by producers or independent gathering companies, by claiming that "the potential for anticompetitive abuse" is not present in the case of these other entities. (FERC Br. at 23-24.) As an initial matter, a federal agency's opinion as to "the potential for anticompetitive abuse" in an activity cannot serve as a substitute for statutory authority to regulate the activity where such power has been denied by Congress. FERC's remedy is to present facts as to alleged "anticompetitive abuse" to Congress and request statutory authority, not to annex unilaterally a nonjurisdictional area.

Second, while the opinion below relies on FERC's assertion that there is a "potential for anticompetitive abuse" by interstate pipelines discriminating against third party transportation volumes in favor of their own system supply (App. at 19a-20a), FERC recently announced that it was necessary "to recognize the current characteristics of the natural gas industry—which is now dominated by pipeline transportation, not by traditional merchant service . . . ." Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation, Notice of Proposed Rulemaking, 56 Fed. Reg. 38,372 (Aug. 13, 1991). Thus, while FERC states that there is no record in this case to support Northern's assertion that "gathering rates are established by a competitive market" (FERC Br. at 24), FERC's own admission that the industry is "dominated" by transportation, not sales of pipeline system supply, supports Northern's statement that "Northern and many other interstate pipelines are now primarily transporters of third-party gas, with the incentive to maximize transportation of such volumes, not discriminate against them." (Pet. at 26.) As a result, there is no basis for FERC's discriminatory regulation of only gathering con-

ducted by interstate pipelines because "all companies which provide gathering, including interstate pipelines, have an incentive to keep their gathering rates competitive in order to maximize use of their gathering facilities." *Id.*[6]

FERC also attempts to justify its discriminatory regulation of gathering by interstate pipelines by alleging that failure to assert jurisdiction "would 'permit the *pipeline* to establish rates for the interstate transportation.' " (FERC Br. at 18, emphasis in original). Yet, FERC wholly fails to explain how an interstate pipeline's unregulated rate for gathering would "establish" the rate for interstate transportation any more than the unregulated gathering rate of producers, independent gathering companies and intrastate pipelines. In each case, regardless of the particular owner/operator of the facility, the rate is for the gathering service, not transportation, and, as the Commission itself previously has found, gathering and transportation are "two functions" which are "mutually exclusive." *Superior Oil, supra,* 13 FERC at 61,497.[7]

6. With respect to the holding extending FERC jurisdiction to an interstate pipeline's separately incorporated affiliate engaged solely in gathering, FERC does not deny that this issue was not argued before FERC or the court below. (FERC Br. at 24, n. 19.) Despite this lack of due

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[6] FERC fails to recognize that an interstate pipeline's gathering service must compete against the gathering service of other interstate pipelines as well as against the gathering service of producers, independent gathering companies and intrastate pipelines. Further, all entities which conduct gathering are subject to competition not only from existing gathering facilities but also from new gathering facilities that could bypass existing systems, including an individual line that would establish a dual gathering connection for a well.

[7] Significantly, neither FERC nor Producers dispute the discriminatory impact of FERC's assertion of jurisdiction based solely on the type of operator—"[t]o the extent FERC's regulation keeps Northern's gathering rates below the unregulated gathering rates charged by producers, gathering companies and intrastate pipelines, producers are able to obtain a higher price for their gas when Northern provides the gathering," thereby transferring dollars "from the pipeline's gathering service . . . to producers' pockets." (Pet. at 26-27.)

process, FERC does not disavow the holding, but, rather, seeks to avoid review by claiming that the issue is "not presented in this case." *Id.* While FERC suggests that "application of the decision below" to a particular affiliate can await future court review (*id.*), the issue squarely presented here is whether FERC has jurisdiction over *any* affiliate of an interstate pipeline which is separately incorporated and engaged solely in gathering. Given that this sweeping holding is in direct conflict with express statutory language and opinions of this Court, review is warranted at this time.

CONCLUSION

For the reasons stated above and in Northern's Petition, Northern respectfully prays that the Court grant review of the opinion below.

Respectfully submitted,

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